

## ALABAMA TAX TRIBUNAL

AGW ENTERPRISES, LLC, and its sole member SAFDHAR KHAN, doing business as AC IN & OUT,	§	
&	§	
SASHA INVESTMENTS, INC.	§	DOCKET NOS. S. 16-989-CE S. 16-1343-CE
Taxpayers,	§	
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

### FINAL ORDER

The Revenue Department entered final assessments of State and local sales tax and prepaid wireless service charges against AGW Enterprises, LLC, (“AGW”) and its sole member Safdhar Khan, for the periods of November 2012 through March 2015. The final assessments were entered on August 1, 2016 as follows: State sales tax assessment in the amount of \$99,658.99, consisting of tax due in the amount of \$63,336.18, interest in the amount of \$4,654.67, and a fraud penalty in the amount of \$31,668.14; local tax assessment for Coosa County, Alexander City, and Goodwater in the total amount of \$110,561.48, consisting of tax due in the total amount of \$70,336.67, interest in the amount of \$5,056.38, and a fraud penalty in the amount of \$35,168.43; prepaid wireless service charge assessment in the amount of \$2,251.85, consisting of tax due in the amount of \$1,915.87, interest in the amount of \$144.38, and a late file penalty in the amount of \$191.85. AGW timely appealed the final assessments to the Tax Tribunal pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a.

The Revenue Department entered final assessments of State and local sales tax and prepaid wireless service charges against Sasha Investments, Inc. (“Sasha”) for the periods of May 2014 through July 2015. The final assessments were entered on November 3, 2016 as follows: State sales tax assessment in the amount of \$37,757.24, consisting of tax due in the amount of \$24,130.55, interest in the amount of \$1,545.06, and a fraud penalty in the amount of \$12,081.63; local tax assessment for Alexander City in the amount of \$35,288.67, consisting of tax due in the amount of \$22,559.32, interest in the amount of \$1,433.34, and a fraud penalty in the amount of \$11,296.01; prepaid wireless service charge assessment in the amount of \$2,401.26, consisting of tax due in the amount of \$2,007.31, interest in the amount of \$193.20, and a late file penalty in the amount of \$200.75. Sasha timely appealed the final assessments to the Tax Tribunal pursuant to §40-2A-7(b)(5)a.

Khan is the single member of AGW and the sole shareholder of Sasha. Kahn, AGW and Sasha are collectively referred to as “Taxpayers.” The appeals share common issues of law and fact and were consolidated for hearing and final resolution.

A hearing was conducted on September 13, 2017. Assistant Attorney Generals Hilary Parks and Mary Martin Mitchell represented the Department. Attorney Brad Howell represented the Taxpayers.

AGW operated two convenience stores during the relevant audit period known as Happy Food Mart and AC In & Out in Alexander City, Alabama, and two convenience stores known as Happy Mart #1 and In & Out in Goodwater, Alabama. The Department audited AGW to determine compliance with State and local sales tax laws. To perform the audit, the examiner requested any and all records necessary to correctly determine AGW’s

sales tax liability. In response to the request, AGW provided incomplete purchase invoices, incomplete bank statements, income tax returns, credit card processing statements, 2014 1099K, vendor lists and sales tax returns. AGW failed to provide the examiner with its cash register z-tapes. Because AGW did not provide complete bank records and failed to provide any sales records, a purchase mark-up audit was performed to determine total taxable sales. Additionally, because AGW did not provide complete purchase records, the Department's examiner obtained additional purchase records from AGW's vendors.

After calculating purchases using information supplied by AGW and its vendors, the examiner determined that AGW's total purchases in the audit period were \$2,072,781.64. AGW reported sales of only \$1,414,329.09 in the audit period. To calculate total taxable sales, the examiner applied the IRS statistical markup for convenience stores of 34.10% and the IRS statistical markup for food service of 180% to hot food sold by AGW. A markup of 3% was applied to AGW's purchases of off-road diesel. Credit was given for substantiated tax-exempt sales. The applicable tax rate was applied to AGW's total taxable sales to determine total tax due. Credit was given for taxes paid. AGW was billed for the additional tax due. AGW failed to remit payment, and the Department assessed AGW for the State and local sales tax and statutory interest.

AGW was also audited to determine compliance with prepaid wireless service charges. During the audit period, AGW failed to charge, collect and remit the 911 charge on its sales of prepaid wireless. AGW was billed for the prepaid wireless service charges AGW failed to collect on its sales of prepaid wireless services. AGW failed to remit payment, and the Department assessed AGW for the charges plus statutory interest.

Sasha operated two convenience stores during the relevant audit period known as Happy Food Mart and AC In & Out in Alexander City, Alabama. The Department audited Sasha to determine compliance with State and local sales tax laws. To perform the audit, the examiner requested any and all records necessary to correctly determine Sasha's sales tax liability. In response to the request, Sasha provided incomplete purchase invoices, incomplete bank statements, income tax returns, credit card processing statements, 1099K, vendor list and sales tax returns. Sasha failed to provide the examiner with its cash register z-tapes. Because the Sasha did not provide complete bank records and failed to provide any sales records, a purchase mark-up audit was performed to determine total taxable sales. Additionally, because Sasha did not provide complete purchase records, the Department's examiner obtained additional purchase records from Sasha's vendors.

After calculating purchases using information supplied by Sasha and its vendors, the examiner determined that Sasha's total purchases in the audit period were \$707,873.49. Sasha reported sales of only \$329,792.90 in the audit period. To calculate total taxable sales, the examiner applied the IRS statistical markup for convenience stores of 34.10%. A 3% markup was applied to Sasha's purchases of off-road diesel. Credit was given for substantiated tax-exempt sales. The applicable tax rate was applied to Sasha's total taxable sales to determine total tax due. Credit was given for taxes paid. Sasha was billed for the additional tax due. Sasha failed to remit payment, and the Department assessed Sasha for State and local sales tax and statutory interest.

Sasha was also audited to determine compliance with prepaid wireless service charges. During the audit period, Sasha failed to charge, collect and remit the 911 charge on its sales of prepaid wireless. Sasha was billed for the prepaid wireless service charges

Sasha failed to collect on its sales of prepaid wireless services. Sasha failed to remit payment, and the Department assessed Sasha for the charges, plus statutory interest.

On appeal, AGW and Sasha argue that the Department's audit methodology is flawed. Specifically, that the Department's audit of Sasha includes purchase invoices of AGW that were also included in AGW's audit ("duplicate invoices") and that the audit overestimated purchases made by both Taxpayers resulting in more tax assessed than actually due. Additionally, Kahn argues that the assessment entered against him in his individual capacity is unlawful. All Taxpayers argue that the Department has not met its burden of proving that the Taxpayers are liable for the fraud penalty. I will discuss these arguments in this order.

After the hearing, the Department removed all duplicate invoices included in the audit of Sasha and AGW. The Department filed a response, along with schedules, showing the deleted invoices and reporting that the final assessments are due to be reduced. After reviewing the Department's response, the Taxpayers filed a response agreeing that all duplicate invoices had been removed from the audits.

All taxpayers are required to maintain adequate records from which their correct tax liability can be accurately ascertained. Code of Ala. 1975, §40-2A-7(a)(1). If a taxpayer fails to provide the Department with accurate records, for whatever reason, the Department is authorized to compute a taxpayer's correct liability using the most accurate and complete information obtainable. Code of Ala. 1975, §40-2A-7(b)(1)a. The Department can also use any reasonable method to compute the liability, and the taxpayer, having failed in the duty to keep good records, cannot later complain that the records and/or method used by the Department is improper or does not reach a correct result. *Jones v. CIR*, 903 F.3d 1301

(10th Cir. 1990); *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App.), cert. denied, 384 So.2d 1094 (Ala. 1980) (holding that a taxpayer must keep records showing the business transacted, and if the taxpayer fails to keep such records, the taxpayer must suffer the penalty for noncompliance.).

The purchase mark-up audit is a simple, oft-used Department method of determining a taxpayer's sales tax liability when the taxpayer fails to keep accurate sales records. See generally, *GHF, Inc. v. State of Alabama*, S. 09-1221 (Admin. Law Div. 8/10/10); *Thomas v. State of Alabama*, S. 10-217 (Admin. Law Div. O.P.O. 5/18/10); *Alsedeh v. State of Alabama*, S. 03-549 (Admin. Law Div. 11/3/04). Because the Taxpayer in this case failed to maintain adequate records from which its sales could be accurately computed or verified, the Department examiner correctly conducted a purchase mark-up audit to reasonably compute the Taxpayers' liability for the audit period. The tax due, as computed by the audit, is by its nature an estimate. However, out of necessity, the examiner was required to estimate the Taxpayers' purchases for parts of the audit period because the Taxpayers failed to maintain adequate records. I have thoroughly reviewed the audits of both AGW and Sasha, and I find the audits to be reasonable and based on the best information available.

For Alabama purposes, a single member LLC is automatically disregarded unless the LLC "checks the box," i.e., affirmatively elects for federal tax purposes to be recognized and taxed as a corporation. See, Code of Ala. 1975, §10-12-8(b); *Alabama Department of Revenue v. Patrick Lee Downing*, Docket No. 2170129 (Ala. Civ. App. 7/20/2018). There is no evidence in this case that AGW elected to be recognized as a corporation for federal

purposes. Consequently, the Department correctly disregarded the LLC and assessed Kahn as the single member of the LLC.

The Department assessed the fraud penalty against the Taxpayers because they substantially underreported their tax liability in the subject years, because their wholesale purchases substantially and consistently exceeded their reported sales, and because the Taxpayers failed to maintain adequate sales records. Code of Ala. 1975, §40-2A-11(d) levies a 50 percent fraud penalty for any underpayment of tax due to fraud. For purposes of the penalty, “fraud” is given the same meaning as ascribed in the federal fraud provision, 26 U.S.C. §6663. Consequently, federal authority should be followed in determining if the fraud penalty applies. *Best v. State, Dept. of Revenue*, 423 So.2d 859 (Ala. Civ. App. 1982).

The existence of fraud must be determined on a case-by-case basis from a review of the entire record. *Parks v. Commissioner*, 94 T.C. 654, 660 (1990). Because fraud is rarely admitted, “the courts must generally rely on circumstantial evidence.” *U.S. v. Walton*, 909 F.2d 915, 926 (6<sup>th</sup> Cir. 1990). Consequently, fraud may be established from “any conduct, the likely effect of which would be to mislead or conceal.” *Id.* The mere under reporting of gross receipts is itself insufficient to establish a finding of fraud, unless there is evidence of repeated understatements in successive periods when coupled with other circumstances showing an intent to conceal or misstate sales. *Barrigan v. C.I.R.*, 69 F.3d 543 (1995).

A taxpayer’s failure to keep adequate books and records, a taxpayer’s failure to furnish auditors with records or access to records, the consistent underreporting of tax, and

implausible or inconsistent explanations regarding the underreporting are strong indicia of fraud. See *Solomon v. C.I.R.*, 732 F.2d 1459 (1984); *Wade v. C.I.R.*, 185 F.3d 876 (1999). Ignorance is not a defense to fraud where the taxpayer should have reasonably known that its taxes were being grossly underreported. *Russo v. C.I.R.*, T.C. Memo 1975-268; *Temple v. C.I.R.*, 67 T.C. 143 (1976).

Fraud can be established by cumulative, circumstantial evidence. The Department has shown by irrefutable evidence that the Taxpayers regularly purchased significantly more inventory than was reported as sales proceeds. Kahn testified at the hearing, but he could not explain how the Taxpayers' returns were consistently, grossly understated.

Any retailer should know with certainty that sales records must be maintained for audit purposes. When asked why the Taxpayers failed to maintain z-tapes or sales journals, Kahn could give no credible answer. Further, he could not testify as to how sales tax was collected on the Taxpayers' retail sales.

The Department's Administrative Law Division, now the Tax Tribunal, has affirmed the fraud penalty numerous times in similar cases, see *Zienni v. State of Alabama*, Misc. 13-294 (Admin. Law Div. 2/7/2014); *Carter Enterprises v. State of Alabama*, S. 11-965 (Admin. Law Div. 6/25/2012); *Melton v. State of Alabama*, S. 05-281 (Admin. Law Div. 4/26/2005). The fact that the Taxpayers' retail sales were more than 50 percent underreported, that the underreporting was consistent throughout the audit period, and that the Taxpayers could not offer a single, plausible explanation for such significant and consistent underreporting supports a finding that the Department correctly applied the fraud penalty against the Taxpayers.



The final assessments entered against the Taxpayers for State and local sales tax, as reduced, are affirmed. Judgment is entered against AGW and Kahn for State and local sales tax in the amount of \$99,044.54 and \$109,814.92, respectively. Additional interest has accrued since date of entry of the final assessments, August 1, 2016, and will continue to accrue until the assessments are paid in full. Judgment is entered against Sasha for State and local sales tax in the amount of \$37,378.47 and \$34,923.30, respectively. Additional interest has accrued since the date of entry of the final assessments, November 3, 2016, and will continue to accrue until the assessments are paid in full.

The final assessments entered against the Taxpayers for prepaid wireless service charges are affirmed. Judgment is entered against AGW and Kahn for prepaid wireless service charges in the amount of \$2,251.85. Judgment is entered against Sasha for prepaid wireless service charges in the amount of \$2,430.58. Additional interest has accrued since the date of entry of the final assessments and will continue to accrue until the assessments have been paid in full.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2B-1(m).

Entered January 14, 2018.

*/s/ C. O. Edwards*

CHRISTY O. EDWARDS

Associate Tax Tribunal Judge

cc: Brad Howell, Esq.  
Mary Martin Mitchell, Esq.  
Hilary Y. Parks, Esq.